

CAI International, Inc.
Form 10-Q
May 10, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 001-33388

CAI International, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

94-3109229
(I.R.S. Employer Identification No.)

Steuart Tower, 1 Market Plaza, Suite 900
San Francisco, California
(Address of principal executive offices)

94105
(Zip Code)

415-788-0100
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Common
Common Stock, \$.0001 par value per share

April 30, 2013
22,143,690 shares

CAI INTERNATIONAL, INC.
INDEX

	Page No.
<u>Part I — Financial Information</u>	4
Item 1. <u>Financial Statements (Unaudited)</u>	4
<u>Consolidated Balance Sheets at March 31, 2013 and December 31, 2012</u>	4
<u>Consolidated Statements of Income for the three months ended March 31, 2013 and 2012</u>	5
<u>Consolidated Statements of Comprehensive Income for the three months ended March 31, 2013 and 2012</u>	6
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012</u>	7
<u>Notes to Unaudited Consolidated Financial Statements</u>	8
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	19
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	26
Item 4. <u>Controls and Procedures</u>	26
<u>Part II — Other Information</u>	27
Item 1. <u>Legal Proceedings</u>	27
Item 1A. <u>Risk Factors</u>	27
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	27
Item 3. <u>Defaults Upon Senior Securities</u>	27
Item 4. <u>Mine Safety Disclosures</u>	27
Item 5. <u>Other Information</u>	27
Item 6. <u>Exhibits</u>	27
<u>Signatures</u>	28

Index

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain forward-looking statements, including, without limitation, statements concerning the conditions in our industry, our operations, our economic performance and financial condition, including, in particular, statements relating to our business and growth strategy and service development efforts. The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for certain forward-looking statements so long as such information is identified as forward-looking and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in the information. When used in this Quarterly Report on Form 10-Q, the words “may,” “might,” “should,” “estimate,” “project,” “anticipate,” “expect,” “intend,” “outlook,” “believe” and other similar expressions are intended to identify forward-looking statements and information. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. These forward-looking statements are based on estimates and assumptions by our management that, although we believe to be reasonable, are inherently uncertain and subject to a number of risks and uncertainties. These risks and uncertainties include, without limitation, those in our Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission (SEC) on February 28, 2013 and our other reports filed with the SEC. We undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law. Reference is also made to such risks and uncertainties detailed from time to time in our other filings with the SEC.

Index

PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CAI INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share information)
(UNAUDITED)

	March 31, 2013	December 31, 2012
Assets		
Current assets		
Cash	\$26,768	\$ 17,671
Accounts receivable (owned fleet), net of allowance for doubtful accounts of \$1,059 and \$794 at March 31, 2013 and December 31, 2012 , respectively	38,877	32,627
Accounts receivable (managed fleet)	12,436	19,131
Current portion of direct finance leases	12,370	10,625
Prepaid expenses	16,421	11,952
Deferred tax assets	2,189	2,189
Other current assets	250	919
Total current assets	109,311	95,114
Restricted cash	10,018	4,376
Rental equipment, net of accumulated depreciation of \$161,114 and \$147,654 at March 31, 2013 and December 31, 2012 , respectively	1,339,757	1,210,234
Net investment in direct finance leases	73,610	74,929
Furniture, fixtures and equipment, net of accumulated depreciation of \$1,314 and \$1,254 at March 31, 2013 and December 31, 2012 , respectively	1,786	1,847
Intangible assets, net of accumulated amortization of \$7,637 and \$7,447 at March 31, 2013 and December 31, 2012, respectively	1,198	1,441
Total assets (1)	\$1,535,680	\$ 1,387,941
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$5,549	\$ 5,985
Accrued expenses and other current liabilities	4,254	8,465
Due to container investors	16,285	18,589
Unearned revenue	7,780	7,893
Current portion of debt	67,830	61,044
Current portion of capital lease obligations	2,033	2,242
Rental equipment payable	53,260	2,561
Total current liabilities	156,991	106,779
Debt	970,949	888,990
Deferred income tax liability	39,950	40,051
Capital lease obligations	4,569	5,084
Income taxes payable	192	192
Total liabilities (2)	1,172,651	1,041,096
Stockholders' equity		

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Common stock: par value \$.0001 per share; authorized 84,000,000 shares; issued and outstanding 22,143,690 and 22,052,529 shares at March 31, 2013 and December 31, 2012 , respectively	2	2
Additional paid-in capital	182,359	181,063
Accumulated other comprehensive loss	(4,096)	(2,917)
Retained earnings	184,764	168,697
Total stockholders' equity	363,029	346,845
Total liabilities and stockholders' equity	\$ 1,535,680	\$ 1,387,941

- (1) Total assets at March 31, 2013 and December 31, 2012, include the following assets of certain variable interest entities (VIEs) that can only be used to settle the liabilities of those VIEs: Cash, \$6,441 and \$3,695; and Rental equipment net of accumulated depreciation, \$79,402 and \$62,286, respectively.
- (2) Total liabilities at March 31, 2013 and December 31, 2012, include the following VIE liabilities for which the VIE creditors do not have recourse to CAI International, Inc.: Debt, \$95,140 and \$75,200, respectively.

See accompanying notes to unaudited consolidated financial statements.

Index

CAI INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(UNAUDITED)

	Three Months Ended March 31,	
	2013	2012
Revenue		
Rental revenue	\$46,623	\$32,487
Management fee revenue	2,230	4,201
Gain on sale of equipment portfolios	-	1,256
Finance lease income	2,106	1,463
Total revenue	50,959	39,407
Operating expenses		
Depreciation of rental equipment	15,333	10,658
Amortization of intangible assets	227	227
Gain on disposition of used rental equipment	(2,636)	(3,095)
Storage, handling and other expenses	4,299	2,006
Marketing, general and administrative expenses	6,188	6,523
(Gain) loss on foreign exchange	(300)	196
Total operating expenses	23,111	16,515
Operating income	27,848	22,892
Interest expense	8,404	5,936
Write-off of deferred financing costs	1,108	-
Interest income	(3)	(5)
Net interest expense	9,509	5,931
Net income before income taxes and non-controlling interest	18,339	16,961
Income tax expense	2,272	2,505
Net income	16,067	14,456
Net income attributable to non-controlling interest	-	(65)
Net income attributable to CAI common stockholders	\$16,067	\$14,391
Net income per share attributable to CAI common stockholders		
Basic	\$0.73	\$0.75
Diluted	\$0.71	\$0.73
Weighted average shares outstanding		
Basic	22,085	19,295
Diluted	22,668	19,704

See accompanying notes to unaudited consolidated financial statements.

Index

CAI INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(UNAUDITED)

	Three Months Ended March 31,	
	2013	2012
Net income	\$16,067	\$14,456
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	(1,179)	777
Comprehensive income	14,888	15,233
Comprehensive income attributable to non-controlling interest	-	(65)
Comprehensive income attributable to CAI common stockholders	\$14,888	\$15,168

See accompanying notes to unaudited consolidated financial statements.

Index

CAI INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(UNAUDITED)

	Three Months Ended March 31,	
	2013	2012
Cash flows from operating activities		
Net income	\$16,067	\$14,456
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	15,465	10,773
Amortization of debt issuance costs	1,692	626
Amortization of intangible assets	227	227
Stock-based compensation expense	336	303
(Gain) loss on foreign exchange	(271)	66
Gain on sale of equipment portfolios	-	(1,256)
Gain on disposition of used rental equipment	(2,636)	(3,095)
Deferred income taxes	(101)	127
Bad debt expense	170	145
Changes in other operating assets and liabilities:		
Accounts receivable	429	(1,151)
Prepaid expenses and other assets	68	(187)
Accounts payable, accrued expenses and other current liabilities	(4,120)	1,545
Due to container investors	(2,304)	2,005
Unearned revenue	(90)	580
Net cash provided by operating activities	24,932	25,164
Cash flows from investing activities		
Purchase of rental equipment	(103,725)	(64,946)
Net proceeds from sale of equipment portfolios	-	10,320
Net proceeds from disposition of used rental equipment	8,475	9,874
Purchase of furniture, fixtures and equipment	(52)	(1)
Receipt of principal payments from direct financing leases	2,612	1,685
Net cash used in investing activities	(92,690)	(43,068)
Cash flows from financing activities		
Stock issuance costs	(148)	-
Exercise of stock options	1,108	-
Proceeds from debt	367,670	141,500
Principal payments on debt	(278,269)	(88,860)
Debt issuance costs	(6,214)	(434)
Increase in restricted cash	(5,642)	(544)
Net cash provided by financing activities	78,505	51,662
Effect on cash of foreign currency translation	(1,650)	(243)
Net increase in cash	9,097	33,515
Cash at beginning of the period	17,671	14,078
Cash at end of the period	\$26,768	\$47,593

Supplemental disclosure of cash flow information

Cash paid during the period for:

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Income taxes	\$2,502	\$1,569
Interest	8,447	4,743
Supplemental disclosure of non-cash investing and financing activity		
Transfer of rental equipment to direct finance lease	\$3,025	\$19,557

See accompanying notes to unaudited consolidated financial statements.

Index

CAI INTERNATIONAL, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) The Company and Nature of Operations

Organization

CAI International, Inc. and its subsidiaries (collectively, CAI or the Company), operates primarily in the international intermodal marine cargo container leasing business. The Company also owns a fleet of railcars, which it leases in North America. The Company generates revenue from two reportable segments: equipment leasing and equipment management. The equipment leasing segment specializes primarily in the ownership and leasing of intermodal containers, while the equipment management segment manages equipment for third-party investors. The Company leases its equipment principally to international container shipping lines located throughout the world. The Company sells equipment primarily to third-party investor groups and provides management services to those investors in return for a management fee.

The Company's common stock is traded on the New York Stock Exchange under the symbol "CAP". The Company's corporate headquarters are located in San Francisco, California.

Basis of Presentation

The accompanying unaudited consolidated financial statements include the financial statements of the Company, its wholly-owned subsidiaries, and its 80% owned subsidiary, CAIJ, Inc. (CAIJ). All significant intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly the Company's financial position as of March 31, 2013 and December 31, 2012, and the Company's results of operations and cash flows for the three months ended March 31, 2013 and 2012. The results of operations and cash flows for the periods presented are not necessarily indicative of the results of operations or cash flows which may be reported for the remainder of 2013 or in any future period. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The accompanying unaudited interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2012, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on February 28, 2013.

(2) Accounting Policies and Recent Accounting Pronouncements

(a) Accounting Policies

There were no changes to the Company's accounting policies during the three months ended March 31, 2013. See Note 2 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, filed with the SEC on February 28, 2013.

(b) Recent Accounting Pronouncements

There have been no recent accounting pronouncements that would have a significant impact on the Company's financial statements.

(3) Consolidation of Variable Interest Entities as a Non-Controlling Interest

The Company regularly performs a review of its container fund arrangements with investors to determine whether a fund is a variable interest entity (VIE) and whether the Company has a variable interest that provides it with a controlling financial interest and is the primary beneficiary of the VIE in accordance with ASC 810, Consolidation. If the fund is determined to be a VIE, a further analysis is performed to determine if the Company is a primary beneficiary of the VIE and meets both of the following criteria under Paragraph 14A of ASC 810:

- It has power to direct the activities of a VIE that most significantly impact the entity's economic performance; and
- It has the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

If in the Company's judgment both of the above criteria are met, the VIE's financial statements are included in the Company's consolidated financial statements as required under ASC 810. The equity attributable to the VIE is shown as a non-controlling interest on the Company's consolidated balance sheet and the after tax result attributable to its operations is shown as a net income or loss attributable to non-controlling interest on the Company's consolidated statement of income.

Index

CAI INTERNATIONAL, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company currently enters into two types of container fund arrangements with investors which are reviewed under ASC 810, Consolidation. These arrangements include container funds that the Company manages for investors and container funds that have entered into financing arrangements with investors. Included among several of the funds that the Company manages, and all of the funds under financing arrangements, are Japanese container funds that were established by a related party under separate investment agreements allowed under Japanese commercial laws (see Note 11). Each of the funds is financed by unrelated Japanese third party investors.

Managed Container Funds

All container funds under management by the Company are considered VIEs because as manager of the funds, the Company has the power to direct the activities that most significantly impact the entity's economic performance including the leasing and managing of containers owned by the funds. With the exception of two specific Japanese funds established in September 2010, the fees earned for arranging, managing and establishing the funds are not significant to the expected returns of the funds so the Company does not have a variable interest in the funds. The rights to receive benefits and obligations to absorb losses that could potentially be significant to the funds belong to the third party investors, so the Company concluded that it is not the primary beneficiary of the funds. With the exception of the sale of containers to the two Japanese funds established in September 2010, the Company recognizes gain on sale of containers to the unconsolidated VIEs as sales in the ordinary course of business. For the three months ended March 31, 2013, the Company sold no container portfolios to the Japanese VIEs. For the three months ended March 31, 2012, the Company sold \$10.3 million of container portfolios to the Japanese VIEs and recognized a gain on sale of \$1.3 million.

In September 2010, the Company transferred approximately \$16.0 million of containers to two specific Japanese funds that were considered VIEs. The terms of the transaction included options for the Company to purchase the containers from the funds at a fixed price. As a result of the residual interest resulting from the fixed price call option, the Company concluded that it may absorb a significant amount of the variability associated with the funds' anticipated economic performance and as a result the Company had a variable interest in the funds. As the Company had the power to direct the activities that most significantly impact the economic performance of the VIEs and the variable interest provides the Company with the right to receive benefits from the entity that could potentially be significant to the funds, the Company determined that it was the primary beneficiary of these two specific VIEs and included the VIEs' assets and liabilities, results of operations and cash flows in the Company's consolidated financial statements. The container equipment, cash held by the container funds and net investment in direct finance leases, were included on the Company's consolidated balance sheet with the offsetting equity related to the funds presented separately as non-controlling interest.

During the third quarter of 2012, the Company terminated its management agreements with the two Japanese VIEs and purchased all the container equipment legally owned by them. As the Company previously consolidated these two Japanese VIEs, the purchase of the containers was considered a repurchase of the non-controlling interest for accounting purposes. The Company paid cash of \$15.3 million and contributed cash and other assets from the two Japanese VIEs of \$4.2 million in consideration for the non-controlling interest of \$19.5 million. No gain or loss was recognized by the Company upon the repurchase of the non-controlling interest and subsequent deconsolidation of the two Japanese VIEs. The results of the VIEs' operations have been included in the Company's consolidated statements of income until the date of deconsolidation. Net income of \$0.1 million attributable to the two Japanese funds is presented as net income attributable to non-controlling interest in the Company's consolidated statements of income.

Collateralized Financing Obligations

During the years ended December 31, 2012 and 2011, and the three months ended March 31, 2013, the Company transferred containers with a net book value of \$85.0 million to Japanese investor funds while concurrently entering into lease agreements for the same containers, under which the Company will lease the containers back from the Japanese investors. In accordance with ASC 840, Sale-Leaseback Transactions, the Company concluded these were financing transactions under which sale-leaseback accounting was not applicable.

The container funds under financing arrangements are considered VIEs under ASC 810 because as lessee of the funds, the Company has the power to direct the activities that most significantly impact each entity's economic performance including the leasing and managing of containers owned by the funds. The terms of the transactions include options for the Company to purchase the containers from the funds at a fixed price. As a result of the residual interest resulting from the fixed price call option, the Company concluded that it may absorb a significant amount of the variability associated with the funds' anticipated economic performance and, as a result, the Company has a variable interest in the funds. As the Company has the power to direct the activities that most significantly impact the economic performance of the VIEs and the variable interest provides the Company with the right to receive benefits from the entity that could potentially be significant to the funds, the Company determined that it is the primary beneficiary of these VIEs and included the VIEs' assets and liabilities as of March 31, 2013 and December 31, 2012, and the results of the VIE's operations and cash flows for the three months ended March 31, 2013 and 2012 in the Company's consolidated financial statements.

Index

CAI INTERNATIONAL, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The containers that were transferred to the Japanese investor funds had a net book value of \$79.4 million as of March 31, 2013. The container equipment, together with \$6.4 million of cash held by the investor funds, has been included on the Company's consolidated balance sheet with the offsetting liability related to the funds presented as collateralized financing obligations of \$95.1 million in the debt section of the Company's consolidated balance sheet. See Note 6 (e). No gain or loss was recognized by the Company on the initial consolidation of the VIEs.

(4) Net Investment in Direct Finance Leases

The following table represents the components of the Company's net investment in finance leases (in thousands):

	March 31, 2013	December 31, 2012
Gross finance lease receivables (1)	\$ 116,118	\$ 116,999
Unearned income (2)	(30,138)	(31,445)
Net investment in finance leases	\$ 85,980	\$ 85,554

(1) At the inception of the lease, the Company records the total minimum lease payments, executory costs, if any, and unguaranteed residual value as gross finance lease receivables. The gross finance lease receivable is reduced as customer payments are received. Approximately \$13.0 million and \$9.1 million of unguaranteed residual value at March 31, 2013 and December 31, 2012, respectively, were included in gross finance lease receivables. There were no executory costs included in gross finance lease receivables as of March 31, 2013 and December 31, 2012.

(2) The difference between the gross finance lease receivable and the cost of the equipment or carrying amount at the lease inception is recorded as unearned income. Unearned income together with initial direct costs, are amortized to income over the lease term so as to produce a constant periodic rate of return. There were no unamortized initial direct costs as of March 31, 2013 and December 31, 2012.

In order to estimate the allowance for losses contained in the gross finance lease receivables, the Company reviews the credit worthiness of its customers on an ongoing basis. The review includes monitoring credit quality indicators, the aging of customer receivables and general economic conditions.

The categories of gross finance lease receivables based on the Company's internal customer credit ratings can be described as follows:

Tier 1— These customers are typically large international shipping lines that have been in business for many years and have world-class operating capabilities and significant financial resources. In most cases, the Company has had a long commercial relationship with these customers and currently maintains regular communication with them at several levels of management, which provides the Company with insight into the customer's current operating and financial performance. In the Company's view, these customers have the greatest ability to withstand cyclical down turns and would likely have greater access to needed capital than lower-rated customers. The Company views the risk of default for Tier 1 customers to range from minimal to modest.

Tier 2— These customers are typically either smaller shipping lines or freight forwarders with less operating scale or with a high degree of financial leverage, and accordingly the Company views these customers as subject to higher volatility in financial performance over the business cycle. The Company generally expects these customers to have less access to capital markets or other sources of financing during cyclical down turns. The Company views the risk of

default for Tier 2 customers as moderate.

Tier 3— Customers in this category exhibit volatility in payments on a regular basis.

Based on the above categories, the Company's gross finance lease receivables were as follows (in thousands):

	March 31, 2013	December 31, 2012
Tier 1	\$ 98,443	\$ 98,611
Tier 2	17,675	18,388
Tier 3	—	—
	\$ 116,118	\$ 116,999

Index

CAI INTERNATIONAL, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Contractual maturities of the Company's gross finance lease receivables subsequent to March 31, 2013 for the years ending March 31 are as follows (in thousands):

2014	\$ 19,007
2015	22,810
2016	16,503
2017	17,705
2018	10,788
2019 and thereafter	29,305
	\$ 116,118

(5) Intangible Assets

The Company amortizes intangible assets on a straight line basis over their estimated useful lives as follows:

Trademarks	1-10 years
Contracts – third party	7 years
Contracts – owned equipment	5-7 years

Total amortization expense was \$0.2 million for each of the three months ended March 31, 2013 and 2012.

Intangible assets as of March 31, 2013 and December 31, 2012 were as follows (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
March 31, 2013			
Trademarks	\$ 1,278	\$ (864)	\$ 414
Contracts- third party	3,650	(3,389)	261
Contracts- owned equipment	3,907	(3,384)	523
	\$ 8,835	\$ (7,637)	\$ 1,198
December 31, 2012			
Trademarks	\$ 1,278	\$ (831)	\$ 447
Contracts- third party	3,650	(3,259)	391
Contracts- owned equipment	3,960	(3,357)	603
	\$ 8,888	\$ (7,447)	\$ 1,441

Index

(6) Debt and Capital Lease Obligations

Debt

Details of the Company's debt as of March 31, 2013 and December 31, 2012 were as follows (dollars in thousands):

Reference	March 31, 2013			December 31, 2012		
	Outstanding		Average	Outstanding		Average Agreement
	Current	Long-term		Current	Long-term	
			Interest			Interest Terminates